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Following is an address by Robert D. Hormats, Assistant Secretary for Economic and Business Affairs, before the Japan-American Energy Forum in Washington, D.C., on June 22, 1981.

The industrial democracies continue to be excessively dependent on insecure supplies of expensive imported oil. Japan and the United States are the world's two largest oil-importing nations. Together our two countries account for nearly half of the developed countries' net oil imports. For both Japan and the United States, energy is a key foreign policy issue and security problem. Leaders in both countries recognize that energy is a potentially divisive element that, if not managed properly, could undercut our close cooperation on other economic, political, and security issues of mutual interest. Because of the importance of energy to both of our nations, this is a particularly appropriate forum to discuss the fundamental situation, the directions of international energy policy now being pursued by the United States, and its relation to U.S. foreign policy.

U.S. international energy policy is based on four major components:

- A sustained national effort—relying primarily on market forces to provide the major incentive—to increase energy production and to encourage greater energy efficiency;
- A firm commitment to cooperation in the International Energy Agency (IEA) both to lower the danger from supply disruptions and to encourage continued common effort to reduce the role of oil in their economies;
- A commitment to promote nuclear power and coal as sources of energy in the industrialized democracies; and
- Support for, and encouragement of, the efforts of the developing nations to increase and diversify energy production.

Current Energy Situation

There is a major risk that the current softness in oil markets will give rise to unjustified complacency. We have indeed made impressive progress in changing the structure of our economies in order to reduce oil use. This, coupled with low economic growth in many countries and an unusually high level of Saudi production, has contributed to declining oil prices.

But the oil market is demonstrably accident prone and vulnerable to political disruption. We should not conclude that the international energy problem has permanently receded. Wars, internal strife, accidents, or political decisions can lead to supply interruptions that bring sharp price increases and demand could once again overtake supply.

My major message today is that the dramatic process of restructuring our energy economies away from dependence on oil must continue in full force. Not long ago many of us were frustrated by the fact that little progress had been made in reducing energy dependence despite the clear warning of the events in 1973. As late as 1977 U.S. oil imports were well over 8 million barrels a day. An extensive network of price controls encouraged consumption and reduced incentives to increase production.

Today, primarily as a result of responses to increased oil prices and supplementary government measures, U.S. oil imports are running at less than 5 million barrels per day and in some recent weeks actually fell below Japan's import level. Japan and other industrialized nations are also making dramatic savings.

But we cannot take continued structural change for granted. We must avoid the psychology of complacency, which caused us to relax our efforts during the 1975–78 period and which again appears to be on the rise. The facts demonstrate that, impelled by higher prices and a sense of urgency, industrialized democracies can use energy much more efficiently than anticipated only a few years ago. Dramatic savings have been realized. Millions of individuals have turned to smaller cars, insulated their homes, turned down their thermostats in winter, settled for less air-conditioning in summer, and conserved their use of electricity. In 1980 U.S. residential oil use was 31% below its 1970 peak.

Virtually every industry has found ways of using less energy: more energy efficient equipment is being purchased, energy-saving methods of production have been developed, and excess heat has been recovered and reused. U.S. oil consumption in 1980 was 10% below the 1978 level while GNP increased by 3%. For the 10 most energy-intensive U.S. industries, energy consumption has actually declined by over 2% since 1972 while their output increased by an average of 20%.

Again responding to price increases, many countries have taken greater advantage of their capacities to increase energy production. Major hydrocarbon resources exist in the United States, the United Kingdom, and Canada. In the United States there has actually been an increase in oil production. Natural gas in North America and the North Sea can be an increasingly important substitute for oil. The number of rigs active in the United States has shot up from 2,100 in 1977 to roughly 4,000 today. The adoption of expedited offshore leasing procedures in the United States can continue this hopeful trend.

Coal is emerging as potentially the most important alternate source of energy in this decade. The recent IEA ministerial meeting [on June 15, 1981] agreed on the need for governments to make greater efforts, in cooperation with industry, to clarify the potential for trade and use of coal and to examine constraints on coal production. The meeting called for a full review of coal policies and programs in 1981. Last year's report of the IEA's Coal Industry Advisory Board conveys a number of useful ideas for increasing coal production and use in the 1980s.

The coal trade needs more long-term commercial contacts, which will lead to investments needed for port and other infrastructure development. The United States will be a reliable supplier of coal; we will not interrupt coal trade under contracted commitments unless compelled to do so by national emergency. The Administration is committed to facilitate, rather than subsidize, efforts to increase coal exports by reducing regulatory delay and uncertainty. The government seeks to improve the ability of the U.S. Army Corps of Engineers to expeditiously obtain prompt permits and to complete dredging projects rapidly. By permitting ports to charge a user fee for dredging, we hope to improve ports at a pace consistent with commercial demand. A doubling of U.S. coal port capacity is already planned or underway. We urge other countries to improve their infrastructure in order better to receive and distribute imported coal. We welcome foreign investment in U.S. coal mining and infrastructure.

Nuclear power clearly must play an increasingly important role in reducing dependence on imported oil. There has been progress in ordering and constructing nuclear power stations in some countries. But in most others activity has been low. There are a number of reasons for this: widespread public opposition to nuclear power, significant delays in the licensing process, complex regulatory requirements, and a resulting climate of uncertainty which discourages new investment. In order to overcome some of these constraints, the United States and its partners in the International Energy Agency have agreed on the importance of prompt national and international action to increase public understanding of reactor safety, to implement waste management and disposal programs, to streamline licensing procedures and shorten lead times while continuing emphasis on safety, to insure that regulatory practices do not unnecessarily constrain investment, and to reinforce the reliability and predictability of international trade in nuclear fuels and technology under appropriate safeguards.

Reducing Vulnerability to Supply Disruptions

Reducing our dependence on imported oil is a slow process. We must therefore be mindful that serious disruptions can from time to time occur. We will remain vulnerable to such interruptions for a considerable time. Following the oil embargo and supply disruptions of 1973, most of the industrialized democracies agreed on an emergency-sharing plan to cope with significant supply disruptions and to form the International Energy Agency to strengthen energy cooperation. The IEA and the emergency-sharing plan have been, and remain today, critical to our economic, foreign policy, and security interests. During and after the 1973 embargo there was a grave risk that individual countries would be forced to make political concessions to oil exporters in order to be assured of vitally needed oil supplies. Had this happened, the world would have faced a major "scramble" for oil with the oil going only to those willing to make political concessions or pay huge sums of money on spot markets. The others would have been left short. Such a process would clearly have undermined support for U.S.-Middle East diplomacy and enormously weakened alliances and friendships in Europe and Asia.

The IEA sharing plan gave America's friends and allies confidence that the United States would share with them if they were the targets of oil blackmail. And it gave us the confidence that would be supported in similar circumstances. It is all too easy for us to forget how vulnerable countries are to disruptions and how vital energy cooperation is to our security and our foreign policy interests.

The IEA has been, and remains, the centerpiece of U.S. international energy policy. The United States today is participating in IEA efforts to maintain a high degree of readiness to cope with oil emergencies. If the emergency-sharing plan is triggered, the United States stands fully ready to meet its obligations under the plan. If disruptions of a lesser magnitude should occur, the United States will consult closely with its IEA partners to consider appropriate responses and to take whatever actions we judge collectively to be necessary. We and our IEA partners agreed at the recent ministerial meeting to be prepared to prevent a disruption in oil supplies from again resulting in sharp price rises and severe economic damage. To improve our emergency preparedness, we and our IEA partners are consulting with industry on the elements of a flexible set of measures which could be utilized.

At that ministerial meeting we also agreed that the "full implementation and strengthening of market forces in consuming countries will contribute heavily" to our ability to manage disruptions and that "supplementary action by governments may be necessary in those areas where market forces do not sufficiently counteract the adverse impact of supply disruptions, particularly in international markets."

The building of safety stocks of oil is essential to preparations for an emergency. During the period after the Iran-Iraq war, drawings on private stocks helped to reduce supply and price disruptions. This year the United States is filling its strategic oil reserve at an average rate of 230,000 barrels per day, with the objective of reaching a level of 750 million barrels by the end of the decade. This would enable us to cope with import disruptions of roughly 2 million barrels per day for a year. We have urged other nations to build up safety stocks as well.

We must also keep a watchful eye on commercial inventories, in order to insure that falling consumption and high interest rates do not cause companies to draw down stocks to dangerously low levels. Our common objective must be to avoid placing ourselves once again in the unfortunate position we were in during the 1978 Iranian revolution. At that time the United States had very little oil in its strategic petroleum reserve, and commercial stocks in the United States and many other countries had been drawn down steadily for a year. Low stock levels deprived the IEA nations of a major tool to deal with the 1979 oil shock in a more effective way. The existence of larger stocks during the Iran-Iraq war of 1980 helped us to weather that crisis more successfully.

In the IEA we also actively support efforts to strengthen and rationalize cooperation in research and development. While the tight U.S. budget has limited our participation in some programs, others remain extremely important. Tax credits and oil price decontrol will stimulate development of these resources. Projects in such areas as fluidized-bed combustion and the breeder reactor are important to our energy futures.

Energy in the Developing Nations

So far I have emphasized energy cooperation among the industrialized nations. I turn now to the acute energy problems of poorer countries. How the developing nations fare in the energy sector is extremely important to the United States, Japan, and other industrialized nations. The large oil-import bills of many developing nations have caused them serious balance-of-payments difficulties, increased their debt burden, and reduced funds to buy other essential imports such as food and machinery needed for their development. Dependence on imports has also made developing nations vulnerable to political pressures from supplying countries. More energy production by developing countries would be of great benefit to developed and developing nations alike. It will contribute to a more favorable global demand-supply balance and thereby reduce the market power of the producers and the potential for future price increases. Energy exports by developing countries will diversify supplies. And these countries would be better able to reduce their financial imbalances and to import more goods from the industrialized nations.

We cannot give in to complacency. Continued restructuring of our energy economies, continued vigilance in dealing with potential disruptions, and continued efforts to help developing nations increase energy production are essential to our future prosperity and security.

A number of developing countries—most recently the Ivory Coast, Argentina, and Guatemala—have been quite successful in increasing energy production. The primary determinant of their success has been the establishment of a favorable climate for private energy investment. Others have created vigorous national energy companies. Yet, exploration in the developing world is going remarkably slowly. There are about 350 active rigs now operating in the non-oil-exporting developing world today, only one-tenth the number in the United States alone.

Why, one might well ask, has progress been so slow? There are many answers: poor investment climates in many developing countries, potential political risk, the possibility that reserves are not of a commercial scale, and perhaps a lack of availability of rigs and people.

The developing countries themselves will need to take the lead in addressing many of the barriers to additional exploration and production. The international community can, however, make an important contribution. Bilateral and multilateral aid has helped developing countries to increase energy production. The international community is now grappling with the problem of whether greater contributions can be made, particularly through the World Bank. My personal conclusion is that World Bank assistance can make an increasingly important contribution to oil, gas, coal, and renewable energy production in developing nations. Others may disagree. There is also a debate as to how, if the World Bank were to play a greater role, it can most effectively do so.

We would want any World Bank program to complement and facilitate, rather than substitute for, the role of the private companies; and we would want to be assured that it supported economically sound projects. We would also expect substantial contributions by the many countries with an interest in helping developing countries increase production—including OPEC [Organization of Petroleum Exporting Countries] nations in a position to contribute.

By helping developing countries increase their energy production—and by participating in projects and thus encouraging governments and private companies to have confidence in one another and in the terms of contracts—the World Bank can, I believe, increase economically viable energy development in these countries.

Relations with the Middle East and OPEC

A related element of U.S. international energy policy is the constructive role the United States is seeking to play in the Middle East. A sense of stability and confidence in the Gulf and the Middle East will reduce the likelihood of further disruption in oil supply. Our efforts to reduce tensions in this area can, as a result, contribute significantly to international energy stability and security.

In addition to our efforts to reduce political and security tensions, the United States and other developed countries have long believed in the importance of close economic cooperation with oil-producing nations. The oil-producing and oil-exporting nations share a common interest in preserving the health of the world economy.

As oil exporters increase their investments in the industrialized nations, they increase their stake in the international economy. Both importers and exporters have an interest in avoiding disruptive surges in oil prices. Producers have, I believe, come to recognize that price surges and supply uncertainties speed up consumer country efforts to reduce dependence on oil. And both producers and consumers recognzie that surges disrupt economies, currencies, and financial markets.

Producers and consumers together have a keen interest in the economic well-being of the developing nations. Their stability contributes to the stability of the regions in which oil producers are located. Their prosperity contributes to international financial stability and to growth in markets for food and manufactured products and the goods which oil-producing countries will be exporting as they attempt to diversify their economies.

Much as the countries of the Organization for Economic Cooperation and Development discuss issues not so much to make decisions but to better understand one another's approaches and to identify areas of consensus which can contribute to their common well-being, so industrial countries and oil-exporting countries could well benefit from increased exchanges. The industrial countries are no longer simply markets for OPEC oil. They are repositories of OPEC investment, markets for other goods that OPEC countries will increasingly wish to sell, sellers of advanced technology, and important sources of security. And OPEC countries are no longer simply sellers of oil. They are collectively the major savers in the world economy, important aid donors, potentially significant participants in non-oil trade, and essential factors in international diplomacy and security.

Too often the debate as to whether or not there should be a dialogue between the industrial world and OPEC confuses the word dialogue with negotiation. In my judgment, questions of practicality and sovereignty limit the potential for meaningful negotiations. But common interests would make a broad discussion useful to both sides. Such a discussion should in no way substitute for nor prejudge multilateral discussions or negotiations in other institutions, but should strengthen the multilateral cooperation which is vital to a strong international economy. The first subject on the agenda might well be how to help finance or otherwise support investments for structural change and growth in developing countries.

Conclusion

The United States and Japan have much to gain through energy cooperation. While markets are currently quiet, we may well be in the eye of a hurricane with potential dangers surrounding us on all sides. In my judgment, the international energy problem represents the single most significant threat to the well-being of the international economy, and our domestic economies, in this decade. We cannot give in to complacency. Continued restructuring of our energy economies, continued vigilance in dealing with potential disruptions, and continued efforts to help developing nations increase energy production are essential to our future prosperity and security. ■

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